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July 22, 2011

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Dear Chairmen, Director and Comptroller:

Regulations proposed by the Prudential Regulators¹ and the Commodity Futures Trading Commission (CFTC)² (Proposed Margin Requirements) increase the necessity of posting collateral by businesses that primarily use financial derivatives to hedge commercial risk, require segregation of collateral for inter-dealer uncleared swap transactions, and impose minimum margin requirements for both cleared and uncleared swaps. These non-transparent and possibly inefficient rules place our fragile economic recovery at risk while doing little to prevent a future financial crisis. The ability to allocate credit to those businesses that can afford it is central to capital formation. Any reduction in the ability of firms to uniquely determine credit allocations for individual entities is a direct assault on capital formation.

In this letter, I highlight the risk and inefficiency of the Proposed Margin Requirements. From the outset, I ask that you keep in mind that to the extent the Dodd-Frank Wall Street Reform and

¹ Margin and Capital Requirements for Covered Swap Entities, Docket No. OCC-2011-0008, (April 12, 2011) (draft, proposed by the Prudential Regulators, which include the Office of the Comptroller of the Currency, the Federal Reserve Board, the Federal Deposit Insurance Corporation, the Farm and Credit Administration and the Federal Housing Finance Agency).

² Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 76 Fed. Reg. 23,732 (April 28, 2011) (to be codified at 17 CFR pt. 23).

Consumer Protection Act³ (Dodd-Frank) requires certain regulations that you expect will cause harm, you should proactively inform Congress and recommend solutions. I am also writing to request that you provide additional information about the rationale for these proposed requirements.

Your respective agencies believe it is prudential, or in good judgment, to impose strict collateral requirements on commercial entities and banks that enter into hedging transactions. On the face of it, such requirements would further improve the capitalization of banks, reducing the risk of their downfall in another crisis. While the extent of the impact can be debated, an over-capitalization of banks will drain cash from the marketplace while the broad imposition of collateral requirements will likely shift capital away from the more credit-worthy commercial businesses in order to capitalize banks and the Treasury.⁴

Based on the new rules, I expect that a large share of this new collateral will be held in the form of Treasuries and U.S. Agency debt.⁵ Currently, about \$4 trillion, or nearly 40 percent, of existing Treasury debt acts as collateral to deals in the repurchase, futures and swaps markets.⁶ The expansion of collateral requirements will likely add trillions of dollars of demand to the Treasury markets.⁷ Increased demand for Treasury bonds should place downward pressure on yields, robbing savers to reward debtors as inflation eats away at wealth. It appears that businesses that hedge commercial risk will have little choice but to expend resources, otherwise devoted to expanding their businesses, to finance government debt.

Upon implementation of the proposed rulemakings, margin and capital requirements in our capital markets will change dramatically.⁸ It appears that the Federal Government will take substantial control over the credit risk management process for cleared and uncleared derivative transactions.⁹ Margin requirements may be adjusted by you, the federal regulators, using the broad authority delegated by Congress.¹⁰ Through your supervisory authority, I expect that you can further oversee and intervene in the credit determination process. To some extent, collateral will take the place of credit determinations as margining requirements increase and as market participants shift to clearing transactions.¹¹ Companies with strong credit may lose their ability to execute non-margining swaps that eliminate cash flow concerns.¹² In many cases, companies that earned strong credit will be told "go post-margin, like all the others."

³ Pub. L. 111-203, 124 Stat. 1376 (2010).

⁴ For current Treasury bill, note and bond yields see Bloomberg, <http://www.bloomberg.com/markets/rates-bonds/government-bonds/us/>.

⁵ Margin and Capital Requirements for Covered Swap Entities, Docket No. OCC-2011-0008 at 12. ("Eligible collateral is generally limited to (i) immediately-available cash funds and (ii) certain high-quality, highly-liquid U.S. government and agency obligations and, in the case of initial margin only, certain government-sponsored enterprise obligations, subject to specified minimum "haircuts" for purposes of determining their value for margin purposes.")

⁶ Michael Mackenzie and Aline van Duyn, Wall Street to Cut Reliance on Treasuries amid Debt Ceiling Fears, Financial Times (June 13, 2011).

⁷ See *id.* See also *infra* note 59.

⁸ *Infra* Parts I.A, II, and III.

⁹ *Id.*

¹⁰ Dodd-Frank requires the prudential regulators for bank swap entities and the CFTC for non-bank swap entities to set both initial and variation margin requirements on all uncleared swaps. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, § 731, 124 Stat. 1376 (2010).

¹¹ Morgan Stanley, US Interest Rate Strategist, The Dodd-Frank Act: How Changes in Transaction Costs May Affect the Rates Market (April 28, 2011) <http://www.fixedincome.com/wp-content/uploads/2011/04/mtb62975.pdf>. ("Our analysis shows that Dodd-Frank will push marginal transactions toward the cash and futures markets. Transaction and other frictional costs associated with margin, capital requirements and processing make cash and exchange-traded products more economically efficient. This will represent a major shift in the behavior of investors who have up till now enjoyed the fluidity of the swaps market.")

¹² See *id.* See also *infra* Parts I.A and II.A.

As the Federal Government takes away a competitive advantage, those firms with good credit will find that their ability to deploy capital will have been reduced as they will likely need to set aside liquid assets for potential margin calls.¹³ A competitive advantage will have been socialized. Credit will play a smaller role in negotiating financial hedges. Firms with good credit that are pushed into the cleared markets or into margining transactions will need to manage cash flow as interim mark-to-market price swings may lead to margin calls.¹⁴

Where previously firms with good credit assured their lenders that key risks were hedged, that they could focus on their core competencies and that their cash flow was secure, now, to the extent the regulators require margining, this may no longer be the case. It appears the regulators, with the help of Dodd-Frank, seek to diminish this ability in the United States of America. Commercial hedging had little or nothing to do with the financial crisis,¹⁵ yet the primary response of the government is to heavily regulate these valuable risk management tools.

What will this do to the credit review process? It will likely weaken it. Why should swap dealers and derivatives clearing organizations (DCOs)¹⁶ seriously consider the credit of their counterparties when excessive margin must be posted in virtually all cases? U.S.-based DCOs and swap dealers will be disadvantaged relative to foreign firms that can provide non-margining agreements or larger extensions of credit to firms of good credit quality. The firms with good credit will have an incentive to shop foreign markets for hedges with lower margining requirements. The firms with weaker credit will likely remain with the U.S. dealers, potentially resulting in adverse selection.

In your capacity as Prudential Regulators, you are imposing substantial overlapping requirements to increase capital and collateral held by banks. Each requirement may take capital away from banks that they could otherwise use for lending to commercial businesses.

Highly leveraged broker dealers, such as Goldman Sachs and Morgan Stanley, began to increase capital through their conversion to bank holding companies, which resulted in a substantial reduction in leverage.¹⁷ Further increases to bank capital or collateral will result from the following: 1) Basel III, which further increases capital requirements;¹⁸ 2) imposition of initial and variation margin requirements on uncleared swaps, which provides additional low cost capital to banks;¹⁹ 3) a push toward cleared derivatives transactions which, by their design, require margin; and 4) restrictions on rehypothecation, which prevent a bank from using margin posted by swap dealers as collateral for other financings.²⁰

¹³ *Infra* Part I.B.iii.

¹⁴ *Id.*

¹⁵ *Infra* note 22.

¹⁶ *Infra* note 35.

¹⁷ Prior to the financial crisis, leverage ratios for broker-dealers were much higher than for banks as banks' leverage ratios were regulated. Upon their conversion to bank holding companies, the remaining broker dealers were required to reduce leverage. See Martin Hutchinson, *Fed's Misplaced Fulcrum* (September 17, 2008), http://www.atimes.com/atimes/Global_Economy/J117Dj02.html.

¹⁸ Moody's Analytics, *Basel III New Capital and Liquidity Standards*, <http://www.moodyanalytics.com/~media/Homepage/Insights/MA-Basel-III-FAQs.ashx>.

¹⁹ *Infra* Part I.A.ii.

²⁰ *Infra* Part III.

While the financial crisis identified the need for improved capital requirements, these improvements need to be made in a prudential and reasonable manner. As you admit, the Prudential Regulators cannot estimate the impact of so many changes occurring at the same time.²¹

To maintain reasonable growth, risks must be taken, and with risk comes the chance of failure. I am concerned that the regulators idealistically seek to prevent *all* future bank failures through excessive capitalization. This is not the Congressional intent behind Dodd-Frank legislation and rulemaking based on that view is inherently flawed.

I believe that multiple overlapping capital requirements and other proposed protections against bank failure will cost the U.S. substantial economic growth. Extended subpar economic growth will competitively disadvantage the U.S. in the long run and, in my view, result in more bank failures than would occur on a path that allows for stronger growth. This concern relates to the benefits of “creative destruction.”²² I would hope the Prudential Regulators and the CFTC consider the gains to productivity that can result from creative destruction.

Risk is a part of life and a crucial ingredient to capitalism; without the potential for failure there can be no success. The savings and loan crisis (S&L crisis) generated far more bank failures from 1986 through 1992 than the current crisis has produced.²³ Other factors may account for the larger number of bank failures and the underlying economic growth during the S&L crisis, but few would dispute that we suffered a crisis. While the FDIC insured depositors during the S&L crisis, extraordinary bailouts such as the Troubled Asset Relief Program (TARP) and extensive quantitative easing did not occur. Nonetheless, the recession of the early nineties caused far less harm when compared to today’s “great recession.”

I. Proposed Regulations that Needlessly Threaten Commercial Business and Our Economy

A. Overview of Proposed Regulations

i. Commercial End-Users that Execute Swaps with Banks Must Post Margin in Excess of a Threshold

Previously, regulators such as the CFTC did not require collateral for commercial businesses, or any entity for that matter. It was presumed that swap dealers such as banks could make their own credit determinations. Risk management by swap dealers related to commercial hedging proved quite accurate

²¹ *Infra* Part IV.

²² E. Bartelsman, J. Haltiwanger and S. Scarpetta, *Microeconomic Evidence of Creative Destruction in Industrial and Developing Countries* (October 2004), http://siteresources.worldbank.org/INTWDR2005/Resources/creative_destruction.pdf at 42.

Interestingly, we find a strong positive and statistically significant correlation between the net entry contribution and the productivity growth of incumbents. This finding is suggestive that there is a relationship between the creative destructive and within firm sources of productivity growth. If nothing else, this strong correlation suggests that these components are not orthogonal alternatives but rather closely related. It might be, however, that the correlation in Figure 13 is readily explained as reflecting the impact of technological advances for both continuing firms and for the creative destruction process. That is, it may be that with technological advances we observe incumbents who survive increase productivity and also observe entering businesses (who presumably adopt the latest advances) more productive than the exiting businesses.

²³ For data on the annual number of bank failures since 1934, see FDIC’s Historical Statistics on Banking, *Failures and Assistance Transactions*, <http://www2.fdic.gov/hsob/HsobsSummaryRpt.asp?BegYear=2011&EndYear=1934&State=1>.

during the financial crisis.²⁴ It appears swap agreements with commercial businesses did not play a significant role in the financial crisis.²⁵

Historically, commercial businesses were not required to post collateral to secure derivatives transactions, which were and continue to be used primarily to hedge against commercial risks. Now, in accordance with Dodd-Frank, you, as the Prudential Regulators propose that swap entities must collect initial and variation margin from commercial end-users subject to a threshold prior to requiring collateral to be posted.²⁶ This enables the end-user to avoid posting collateral up to a stated limit, or threshold. Variation margin would only apply to the extent the sum of initial and variation margin exceeds the threshold.²⁷ However, thresholds may provide little protection from margin requirements given that supervisory authority of the Prudential Regulators likely empowers bank regulators to lower thresholds if they feel banks are taking excessive risks. Furthermore, as you will read in Part II A herein, the Prudential Regulators propose potentially excessive initial margin requirements for uncleared swaps, which will reduce the benefit of thresholds.

ii. *Imposition of Margin Requirements for Uncleared Swaps*

Under the proposed rules of the CFTC and the Prudential Regulators, *swap entities*,²⁸ including those entities the CFTC deems swap dealers, will be required to post initial and variation margin on swaps executed with other swap entities without the benefit of a threshold.²⁹ To the extent the CFTC deems some commercial entities, such as energy companies that also act as financial market makers, to be swap dealers or major swap participants, collateral posting will be required for these commercial entities as well.³⁰ These swap dealers will need to clear transactions when applicable (where cleared transactions require initial and variation margin and do not allow for thresholds), and must post initial and variation margin on uncleared swaps executed with other swap entities.³¹

²⁴ AIG has been widely recognized as the primary culprit in the contribution of derivatives to the financial crisis. See, e.g., William Byrnes, AIG Marked as Central Player in the Financial Crisis Blame Game, <http://profwilliambyrnes.com/2011/03/15/aig-marked-as-central-player-in-the-financial-crisis-blame-game/>. It is important to recognize that AIG, MBIA and Ambac, which all suffered dramatic Credit Default Swap (CDS) related losses, were not market-makers. They were CDS sellers that took one-sided speculative long positions on the credit risk in Collateralized Debt Obligations (CDOs) to insure the credit of CDOs for counterparties. See Tom Armistead, AIG's Speculative CDOs in Perspective, <http://seekingalpha.com/article/110388-aig-s-speculative-cdos-in-perspective>. This form of speculation should not be confused with a swap dealer's general willingness to take either side of a swap (long or short) as a market-maker. See U.S. Securities and Exchange Commission, Market Maker, www.sec.gov/answers/mktmaker.htm.

²⁵ *Id.*

²⁶ Margin and Capital Requirements for Covered Swap Entities, Docket No. OCC-2011-0008 at 17.

²⁷ An example: Assume initial margin for a transaction equals \$1 million and a threshold is set at \$3 million. Collateral must be posted only when the position moves against the commercial end-user by more than \$2 million, at which point the threshold is exhausted. Posted amounts are rounded to \$100,000 so that if the position reflects an initial margin of \$1,000,000 loss of \$2,060,000 to the commercial end-user, \$100,000 must be posted.

²⁸ The rules issued by the Prudential Regulators will apply to swap dealers and major swap participants, or collectively, "swap entities." The rules issued by the CFTC will apply to non-bank swap entities.

²⁹ Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 76 Fed. Reg. 23733-23736; Margin and Capital Requirements for Covered Swap Entities, Docket No. OCC-2011-0008 at 10-12.

³⁰ Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant," 75 Fed. Reg. 80179 (December 21, 2010) (to be codified at 17 CFR pt. 1) ("A non-financial company that engages in both swap dealing and other commercial activities would fall within the definition of swap dealer because of its swap dealing activities, notwithstanding that it also engages in other commercial activities.").

³¹ Margin and Capital Requirements for Covered Swap Entities, Docket No. OCC-2011-0008 at 64.

Unless these swap entities forego doing business with other swap entities, which would be a concerning development, mandatory margin posting will substantially increase for swap dealers and those commercial entities that the CFTC deems to be swap dealers or major swap participants.

B. Why the Proposed Regulations Should Not Apply to Commercial End-Users of Derivatives

i. Commercial End-Users Do Not Pose Systemic Risk

The Prudential Regulators recognize “the minimal risks that nonfinancial end-users pose to the safety and soundness of covered swap entities and U.S. financial stability.”³² Therefore, based on their own evaluation, the regulators should not require commercial end-users to post collateral on swaps.

Commercial businesses provide banks a diversified global profit opportunity. Commercial end-users produce different products or services in different locations, using different management practices and facing different risks. Unlike excessively leveraged speculation on real estate, mortgage backed securities (MBS) and collateralized debt obligations (CDOs) by AIG, Lehman and Bear Stearns, commercial end-users had little to do with the financial crisis.³³ Commercial hedges executed by end-users reduce the volatility of cash flow and earnings, enabling these end-users to focus on their business and improve efficiencies.³⁴ At the point where commercial end-users generate broad systemic concerns, we should be worried about far more than failing banks.

ii. Extension of a Low Rate Loan from Commercial Business to Banks is the Opposite of What is Needed

To the extent new margin requirements mandate increased posting of collateral, this will likely draw capital away from commercial businesses. The posting of collateral by a commercial end-user can be viewed as a loan from a commercial business, such as an energy producer, airline, or manufacturer, to a swap dealer. This collateral secures the bank in case the business defaults on their obligation to the bank. Collateral posted by a commercial business to a bank currently yields low interest (whether cash or Treasury/Agency debt).³⁵ The net cost of posting collateral equals its opportunity cost, which is the return on a missed opportunity less the return on posted collateral.³⁶

Commercial businesses will suffer substantial opportunity costs when required to increase the posting of collateral. Instead of increasing lending from banks to commercial businesses, we expect to see lending from commercial businesses to banks in the form of posted collateral, despite the fact that commercial businesses had little or nothing to do with the financial crisis. To replenish the funds posted as collateral, commercial businesses will need to borrow more, increasing their debt burden and their marginal cost of capital.

³² Id. at 16.

³³ Supra note 22.

³⁴ See David Disatnik, Ran Duchin, and Breno Schmidt, Cash Flow, Hedging and Liquidity Choices, <http://www.bus.emory.edu/breno/papers/hedging.pdf>.

³⁵ For current Treasury bill, note and bond yields see Bloomberg, <http://www.bloomberg.com/markets/rates-bonds/government-bonds/us/>.

³⁶ Definition of “Opportunity Cost,” Research Tools, THE ECONOMIST, <http://www.economist.com/research/Economics/alphabetical.cfm?letter=O>.

Given the Federal Reserve's promise to keep short-term interest rates at or near zero, to the extent the proposed rules result in additional and broad posting of collateral by commercial end-users, the transfer of wealth will be substantial as these commercial hedgers provide valuable capital to banks and DCOs³⁷ for a certain and enormous lending loss.

iii. The Cash Flow Benefits of Non-Margining Agreements Provide Commercial Businesses with the Opportunity to Deploy Capital More Efficiently

The required posting of variation margin by commercial end-users directly impacts their cash flows. When variation margin is required, as a financial hedge moves against an entity, it generally posts cash or similarly liquid collateral. Larger price swings in the short run can increase cash flow risk to commercial hedgers that post margin, despite an entity's ability to satisfy the hedge in the long run through production.³⁸ The story of Metallgesellschaft AG, a large German conglomerate, provides a clear example of this risk.³⁹ In 1993, Metallgesellschaft AG use of futures products as a hedge placed an enormous cash flow burden on a company that otherwise had a hedged position.⁴⁰ Had Metallgesellschaft used non-margining financial swaps backed by a lien on its physical assets, it likely would have avoided a cash flow crisis that resulted in a premature unwind of its hedge at a loss, which resulted in a \$1.9 billion bailout from its bankers.⁴¹

The case of Metallgesellschaft highlights the important role of non-margining swap agreements and similar extensions of credit to enable sound commercial hedges. Alternatives to the posting of cash or Treasury debt must be allowed to protect commercial businesses from redirecting valuable capital to cover short term cash flow risks for those positions that are hedged over the long run.

iv. Commercial Businesses Provide Greater Security in Times of Crisis

As the recent financial crisis has revealed, under mark-to-market accounting, financial assets can broadly suffer major price declines.⁴² Mark-to-market accounting required financial entities to recognize extraordinary losses on asset backed securities, equity, commodity and other investments.⁴³ Commercial entities that primarily generate cash flow from production or services did not generally suffer this valuation problem. During the financial crisis, while some commercial businesses failed, these failures

³⁷ A derivatives clearing organization (DCO) is a "clearinghouse, clearing association, clearing corporation, or similar entity that enables each party to an agreement, contract, or transaction to substitute, through novation or otherwise, the credit of the DCO for the credit of the parties; arranges or provides, on a multilateral basis, for the settlement or netting of obligations; or otherwise provides clearing services or arrangements that mutualize or transfer credit risk among participants. Any clearinghouse that seeks to provide clearing services with respect to futures contracts and options on such futures contracts traded on a designated contract market (DCM) must register with the CFTC as a DCO before it can begin providing such services." U.S. Commodity Futures Trading Commission, Derivatives Clearing Organizations, <http://cftc.gov/IndustryOversight/ClearingOrganizations/index.htm>.

³⁸ *Cash Flow, Hedging and Liquidity Choices* at 4. ("Consistent with the precautionary saving theory, the evidence presented in the cash literature suggests that firms with riskier cash flows hold more cash, and that cash plays an important role when market frictions might force firms to forego valuable future investments.")

³⁹ See Anand Shetty and John Manley, Metallgesellschaft's Hedging Debacle, <http://userwww.sfsu.edu/~ibec/papers/39.pdf>.

⁴⁰ *Id.*

⁴¹ *Id.*

⁴² Paul Davies, True Impact of Mark-to-Market Accounting in the Credit Crisis, *FINANCIAL TIMES*, February 29, 2008.

⁴³ Tobias Adrian and Hyun Song Shin, Liquidity and Leverage, (May 2008)

<http://www.imf.org/external/np/seminars/eng/2008/finycl/pdf/adsh.pdf>. ("If we hypothesize that greater supply of the asset tends to put downward pressure on its price, then there is the potential for a feedback effect in which weaker balance sheets lead to greater sales of the asset, which depresses the asset's price and lead to even weaker balance sheets.")

cannot compare to the carnage of the largest broker-dealers, who all held strong and stable credit ratings prior to the financial crisis.⁴⁴

British Petroleum (BP) provides an excellent example of the stability provided by physical assets and the cash flows generated by those assets. Despite massive uncertainty with regard to its liability in the Macondo tragedy and the resulting reputational harm, and despite its extensive use of derivative products that are marked to market, BP never came close to the fate of Lehman Brothers, AIG or Bear Stearns.⁴⁵ BP's physical assets, the type of assets that the Prudential Regulators refuse to consider as collateral for derivatives, have kept BP from the fate of some of our largest financial institutions. BP's share price declined substantially from around \$60 a share to a brief low of \$27/share but, unlike Lehman, AIG and Bear Stearns, never approached a zero valuation.⁴⁶

v. *The Natural Protection of "Right Way Risk"*

I am concerned with the regulators' refusal to permit the posting of certain valuable forms of collateral. For example, under the proposal by the Prudential Regulators, commodity and energy producers that seek to execute financial swaps relating to the production of their own commodities cannot allow for liens against these commodities as collateral.⁴⁷

Regarding non-bank entities that fall under CFTC jurisdiction, a determination that a commodity producer is a swap dealer will cause a share of its transactions to be cleared, which prevents use of physical assets as collateral for those transactions.⁴⁸

The regulators' concern about types of collateral is particularly troubling given that certain commodity-backed transactions generate "right way risk" to the dealer.⁴⁹ This fundamental principle of risk management provides that, in certain situations, as losses accrue to a commercial hedger from its forward sale of a commodity position, the collateral's value rises, protecting the bank-counterparty without need to call for variation margin throughout the life of the transaction.

vi. *The Costs of the Proposed Margin Requirements Impact Firms with Better Credit*

⁴⁴ Moody's Investors Service Announcement, Moody's Comments on U.S. Investment Bank and Commercial Bank Subprime Exposures, (August 3, 2007) ("Moody's is maintaining an active dialogue with the five large U.S. investment banks that it rates: Bear Stearns, Goldman Sachs, Lehman Brothers, Merrill Lynch, and Morgan Stanley. All have stable rating outlooks, except for Lehman Brothers, which has a positive outlook.")

⁴⁵ Yahoo Finance, BP Historical Prices, <http://finance.yahoo.com/echarts?s=BP+Interactive#chart1:symbol=bp;range=5y;indicator=volume;charttype=line;crosshair=on;ohlvalues=0;logscale=on;source=undefined>.

⁴⁶ *Id.*

⁴⁷ An example: A successful oil company sells the physical oil it produces at market prices. This oil company may seek to lock in a forward price for oil by executing a cash-settled financial swap where the bank pays the producer the difference when oil drops below \$80/barrel on a monthly basis for the next 3 years and the producer pays the bank the difference when oil exceeds \$80. If the market price for physical oil falls to \$50 (the market price of oil), the bank pays the producer \$30 multiplied by the contracted number of barrels for that month. When the price of oil rises to \$100, the producer owes the bank \$20. What is important to note is that when the market price for oil exceeds the swap contract price, the value of the oil producers' oil assets are higher as well, reducing risks to the bank. If the bank receives the right to place a lien on the oil assets, then the collateral value rises at times when the bank is at risk. See KPMG, Credit and Liquidity Risk Management at 4, <http://www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/Documents/Credit-and-Liquidity-Risk-Management-Better-Practices-for-the-Energy-Industry.pdf>.

⁴⁸ For example, at the CME Group, currently only cash and Treasuries can be posted without application of a haircut and the only physical asset that can be posted is gold, subject to a 15% haircut. CME Group, Standard Acceptable Collateral, <http://www.cmegroup.com/clearing/financial-and-collateral-management/>.

⁴⁹ See *id.* for a definition and example of "right way risk."

New and increased margin requirements impact those firms that previously did not post margin or posted less margin. If we logically assume that banks and swap dealers previously provided greater extensions of credit to counterparties with stronger credit, then costs of the new margin requirements fall predominantly on those counterparties. This is a tax on credit quality.

II. Proposed Margin Calculation Requirements Pose Substantial Risk to Market Liquidity and the Economy

A. An Error by the Prudential Regulators Will Result in Excessive Margin for Uncleared Swaps

Given the likely harm to liquidity that will result from the imposition of mandatory margin requirements for uncleared swaps, I am especially concerned with the method for calculating margin on these uncleared swaps. The Prudential Regulators propose to apply a method that may substantially increase initial margin requirements for uncleared swaps, which would increase the size of the posted margin, or bring the counterparty closer to the threshold where margin applies, effectively increasing margin requirements.

The Prudential Regulators propose a “minimum time horizon for the initial margin model of 10 business days, compared with a typical requirement of three to five business days used by derivatives CCPs.”⁵⁰ Application of a longer time horizon requires the swap dealer to consider potential adverse price movements over a ten-day period, despite the fact that, in most cases, risk of further loss can be closed off in far less time. This ten-day requirement will increase the initial margin that must be posted for uncleared swaps. The Prudential Regulators attribute this change to the fact that “non-cleared swaps are expected to be *less liquid than cleared swaps*”⁵¹ (emphasis added).

When a swap dealer enters into an uncleared or over-the-counter (OTC) swap with a counterparty, to the extent a default by the counterparty occurs, it is the dealer’s *hedge* of the uncleared trade that must be immediately managed or offset by the dealer, not the “less liquid” over-the-counter swap transaction.⁵² To maximize profits, hedging will tend to occur in the deepest, most liquid markets available to offset the risks of the over-the-counter swap.⁵³ Therefore, the liquidity of the uncleared swap’s *hedge* should determine initial margin requirements, not the liquidity of the swap itself.

Given the apparent broad and substantial increases to proposed capital and margin requirements across the board, I am concerned that the Prudential Regulators are simply searching for a basis to justify larger initial margin requirements for uncleared swaps. The complexity of the derivatives markets provides ample cover for the application of erroneous logic, while the fear of upsetting their regulators

⁵⁰ Margin and Capital Requirements for Covered Swap Entities, Docket No. OCC-2011-0008 at 40.

⁵¹ *Id.*

⁵² “Complexity is not nearly so significant an issue as it is made out to be. While tailored OTC derivatives cannot be directly hedged, they can always be broken down into their constituent components of forwards [futures] and options which can and should be managed at the portfolio level by hedging only the net position in each. Applying this sort of reasoning to traditional bank products as mortgages is one of the very positive ways in which derivatives risk management has reduced the overall riskiness of banks.” Michael R. Darby, *Over-The-Counter Derivatives and Systemic Risk to the Global Financial System*, National Bureau of Economic Research, (July 1994) <http://www.nber.org/papers/w4801.pdf>.

⁵³ Mercatus Energy Advisors provides an example: “Jet fuel is often hedged with heating oil as the futures and OTC derivatives market for heating oil futures, swaps and options is much more liquid than the derivatives market for jet fuel.” Mercatus Energy Advisors, *Top Seven Old & Gas Hedging Mistakes*, <http://www.mercatusenergy.com/blog/?month=4&year=2010>.

may be keeping many companies from pointing out such errors. The Prudential Regulators should immediately recognize the likely harm this new requirement will cause and allow swap dealers to determine the appropriate initial margin.

B. Excessive Mandatory Margins for Cleared Transactions

The CFTC is proposing “Risk Management Requirements for Derivatives Clearing Organizations” that will mandate minimum initial margins for cleared swaps, futures and options.⁵⁴ Proposed rule 39.13(g)(2)(iii) requires DCOs to apply a minimum five business-day time horizon for cleared swaps that were originally executed off-exchange.⁵⁵ A DCO would be required to apply one business-day time horizon for all other products that it clears, but “would be required to use longer liquidation times, if appropriate, based on the unique characteristics of particular products or portfolios.”⁵⁶

As justification for the five day minimum, the CFTC “believes that a minimum of five business days is appropriate for cleared swaps that are not executed on a DCM in that *such a time period may be necessary to close out swap positions in a cost-effective manner*”⁵⁷ (emphasis added). In this case, it appears the CFTC applies similar logic as that of the Prudential Regulators and assumes the need for more time to close off the risk of adverse price movements post-default.

The economic concern here is the same as that which applies to the calculation of initial margin for uncleared swaps described above. The liquidity of the cleared swap’s hedge should determine initial margin requirements because it is the hedge that must be adjusted when a default occurs.⁵⁸

III. Proposed Regulation that Substantially Harms the Economy: The Restriction on Rehypothecation of Initial Margin among Swap Dealers

The Prudential Regulators propose that swap entities “must require each derivative’s counterparty that it faces that is a swap entity to segregate any funds or collateral that the covered swap entity has posted as initial margin for a non-cleared swap or non-cleared securities-based swap transaction at an independent third-party custodian.”⁵⁹ The CFTC proposes an equivalent requirement.⁶⁰

A. Segregated Collateral Acts to Deleverage Banks and Swap Dealers in a Non-Transparent Manner

Under the CFTC and Prudential Regulators’ proposals, *swap* dealers must segregate this initial margin by providing it to a third party independent custodian. This proposed rule prevents a swap entity from applying margin posted to it, by another swap entity, as collateral in a different transaction. As a result, this restriction will likely tie up a large share of collateral in segregated accounts. Swap dealers

⁵⁴ Risk Management Requirements for Derivatives Clearing Organizations, 76 Fed. Reg. 3,698 (January 20, 2011) (to be codified at 17 CFR pt. 39).

⁵⁵ *Id.* at 3,704.

⁵⁶ *Id.*

⁵⁷ *Id.*

⁵⁸ *Supra* notes 50, 51.

⁵⁹ Margin and Capital Requirements for Covered Swap Entities, Docket No. OCC-2011-0008 at 38.

⁶⁰ Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 76 Fed. Reg. 23,732 (April 28, 2011) (to be codified at 17 CFR pt. 23).

will lose the ability to reinvest this collateral posted by other swap dealers to finance other lending or derivative transactions, reducing capital formation.

B. Segregated Capital is a Poor Substitute for Capital Requirements

Secured parties can only access segregated collateral in case of default by the specific swap dealer counterparty. From the perspective of systemic risk, collateral maintained in segregated accounts is a poor substitute for capital. Segregated collateral is only accessible when the specific counterparty triggers specified credit provisions such as a default or downgrade, while capital on a balance sheet can protect a firm against any defaulting counterparty or losses generally. Given this restriction, prohibiting rehypothecation is less effective at reducing systemic risk when compared to other methods.

C. Segregated Collateral will Drain Liquidity from the Markets and Our Economy

It appears that segregation of posted collateral will drain liquidity from the entire economy while providing far less protection against systemic risk than capital or reserves. As Matt Cameron of *Risk Magazine* reported:

Based on an annual average growth in notional swap amounts of \$15 trillion, in addition to an unspecified proportion of renewal and replacement trades, the OCC estimates that initial margin in one year could total \$2.56 trillion. However, assuming that 20% of trades are centrally cleared, the initial margin estimate would be \$2.05 trillion - an impact the OCC claims would likely be reduced if dealers use internal margin models, which allow netting and hedging benefits within four risk categories.

But some dealers claim the regulators' estimate is on the conservative side. "The numbers are just incredible. Using one of the proposed initial margin models, we calculated that the total amount of margin we would be required to collect and segregate from our largest 34 counterparties would total \$1.4 trillion. I just can't believe the regulators didn't take into account the liquidity impact of these proposals. We might as well just shut down the US financial system and go home," says one derivatives dealer at a large U.S. bank in New York.

Concerns over the potential impact of segregation are widespread. "We made the case to regulators that initial margin in dealer-to-dealer trades would be ludicrous if we didn't have the ability to rehypothecate. By requiring that the assets be segregated, the regulators have created a liquidity vacuum," says another derivatives dealer.⁶¹

As stated above, the OCC estimates that segregated initial margin posted to national banks in one year will total \$2.56 trillion.⁶² The OCC's analysis is restricted to the collateral expected to be posted to national banks, federally chartered branches of a foreign banks, and federal savings associations.⁶³ The

⁶¹ Matt Cameron, US Margin Proposals Could Lock Down \$2 Trillion in Assets, *RISK MAGAZINE*, June 2, 2011.

⁶² Office of the Comptroller of the Currency, Unfunded Mandates Reform Act Impact Analysis for Swaps Margin and Capital Rule at 5 (April 15, 2011).

⁶³ *Id.* at 2.

posting of segregated collateral to other entities, which are not regulated by the OCC, should increase this estimate.

Simply put, regulators will require commercial businesses to lend cash to banks at a loss. Meanwhile, banks themselves will find a large amount of inaccessible cash sitting idle with custodians that could otherwise help facilitate additional financial transactions.

IV. The Prudential Regulators Have No Idea What Will Happen

As the Prudential Regulators state in the proposed rulemaking:

The new requirements will have an impact on the costs of engaging in new swap transactions. In particular, the proposed rule sets out requirements for initial and variation margin that represent a significant change from current industry practice in many circumstances. *Assessing the quantitative impact of the proposed requirements is particularly difficult in light of the wide ranging and as yet undetermined changes that are occurring to the derivatives market as a result of regulatory reform.*⁶⁴ (italics added).

This is a striking admission from the Prudential Regulators, who are responsible for providing good judgment rules of the road for market participants. It is inconceivable to me how a rule can possibly be made in good judgment if one cannot figure out with any degree of certainty what that rule's consequences would be. Consistent with the insecurities of the Prudential Regulators, *Politico* reported the following apt description:

GERMAN BANKER SLAMS U.S. REFORMS - *Reuters'* Peter Elstob: Europe's relatively pragmatic approach to reforming derivatives regulation offers 'a terrific opportunity' at the expense of the United States, which risks scoring '*one of the biggest own-goals in financial markets history*,' a senior banker said. 'The US, through Dodd-Frank and other means, is excessively focused on derivatives markets,' Colin Grassie, chief executive of Deutsche Bank's operations in the United Kingdom, [said]. ... Grassie said that Europe's reforms of over-the-counter derivatives were, so far, more pragmatic than those in the US, and 'much more in tune' with the derivatives markets.⁶⁵ (emphasis added).

As a member of the Conference Committee that reconciled the Senate and the House of Representatives versions of the Dodd-Frank Act, I am deeply troubled by the potential economic impact of these rules and risks to our global standing. One of the major concerns members of the Conference Committee voiced during deliberations was that the Congressional intent of the Act must be followed by the executive rulemaking. These concerns were, unfortunately, prescient.

V. Conclusion

⁶⁴ Margin and Capital Requirements for Covered Swap Entities, Docket No. OCC-2011-0008 at 50.

⁶⁵ Ben White, *Morning Money*, POLITICO, June 15, 2011.

If we consider these expected changes in the aggregate, the loss of liquidity in the marketplace and the increased purchase of Treasury and Agency debt may be astounding. See Appendix A for a simplified flow diagram summarizing how this is expected to occur.⁶⁶ The impact in terms of the increased cost of maintaining hedges will inevitably reduce hedging and increase the extent of unwinds based on cash flow concerns, such as in the case of Metallgesellschaft. This is a major step backwards in the regulation of our financial markets.

The imposition of excessive margin regulation under the cover of extreme complexity highlights the danger of providing such latitude to regulators through poorly drafted legislation. If the CFTC and Prudential Regulators want banks to build up additional reserves, they should make banks raise the capital in a direct and transparent manner so that regulators, Congress, the markets and the public can properly evaluate whether the reserve requirements are sufficient or excessive and also consider the related impacts to monetary policy.

The potential deleveraging that will result from the new margin requirements and segregation of capital likely contributes to predictions of sluggish economic growth for the foreseeable future and the potential for deflation. I expect these poorly conceived rules will reduce capital for commercial businesses and increase their financing costs.

Questions

To better understand the purpose and reasoning behind the proposed regulations of both the Prudential Regulators and the CFTC, I request that each of you provide responses to the following questions (the Prudential Regulators may provide a unified response) and produce documents as requested and as necessary to sufficiently support your answers. Please directly respond to each question as numbered herein. Provide any documents requested, in electronic format, for the time period from January 1, 2010, to the present, unless otherwise specified:

Proposed Application of a Capital Charge for Uncleared Swaps of End-Users

1. The CFTC permits end-users that execute uncleared swaps to avoid margin requirements but then imposes a capital charge (yet to be defined) on the swap dealer counterparty. Do you agree that the costs of this capital charge will be passed on to the counterparty and will incentivize swap dealers to avoid facilitating uncleared trades with end-users? Please explain and provide documentation and analysis. Please also provide communications among CFTC senior staff and executives pertaining to this issue.
2. If end-users were expected to be exempt from clearing requirements, as recognized by Senator Dodd and many others,⁶⁷ and the Prudential Regulators recognize the minimal risks posed to the

⁶⁶ In the delivery email, see the attached "Appendix A to proposed margin letter" powerpoint. Click the mouse to proceed through the presentation.

⁶⁷ See Letter from Sen. Chris Dodd, Senate Committee on Banking, Housing, and Urban Affairs and Sen. Blanche Lincoln, Senate Committee on Agriculture, Nutrition, and Forestry to Rep. Barney Frank, Chairman, House Financial Services Committee and Rep. Colin Peterson, Chairman, House Committee on Agriculture (June 30, 2010). See also Letter from Sen. Debbie Stabenow, Chairman, Senate Committee on Agriculture, Nutrition and Forestry, Sen. Tim Johnson, Chairman, Senate Committee on Banking, Housing and Urban Affairs, Rep. Frank D. Lucas,

financial system by such end-users, why is the CFTC imposing a mandatory capital charge? Is the capital charge intended to incentivize clearing transactions? Please explain and provide documentation sufficient to support your answer. Please provide the range of capital charges that the CFTC is considering.

Liquidity Premium

3. If commercial end-users seek to post commodities as collateral, does the CFTC plan to apply a liquidity premium? If so, please explain, and provide all related analysis including cost-benefit analysis. Please also provide communications among CFTC senior staff and executives pertaining to this issue.

Supervisory Authority

4. Can the Prudential Regulators or the CFTC, under their supervisory authority, affect those credit review processes of swap dealers that determine the thresholds imposed on trades with non-financial end-users? For example, can the Prudential Regulators require a swap dealer under their jurisdiction to lower thresholds for specified commercial end-users or for end-users generally? Please explain and provide documentation sufficient to support your answer.
5. Is it more likely that the Prudential Regulators will affect collateral processes to reduce thresholds for end-users at times when a bank's financial condition deteriorates? Is this consistent with maintaining safety and soundness of the financial system? Please explain and provide documentation sufficient to support your answer.

Calculation of Initial Margin

6. Do the Prudential Regulators and the CFTC agree that to mitigate risk relating to the default of an uncleared swap, the non-defaulting swap dealer must first unwind or alter the hedge on the swap in order to prevent further adverse market movements?
7. Do the Prudential Regulators and the CFTC agree that the liquidity of the swap itself is not an appropriate basis for the imposition of a 10 day time horizon to the initial margin model for uncleared trades? Please explain your reasoning and provide documentation sufficient to support your answer. Please provide all related analysis including cost-benefit analysis.

Impact of Margin Requirements on Commercial Businesses and Hedging

8. Do you agree that those commercial businesses that continue to hedge despite increased margin requirements will suffer increased opportunity costs? Please explain and provide all related analysis including cost-benefit analysis.

9. Do you expect that earnings volatility may rise as entities choose to avoid financially hedging commercial risk due to the cash flow risk associated with margining requirements? Please explain and provide all related analysis including cost-benefit analysis.
10. If commercial hedging declines and earnings volatility follows, do the Prudential Regulators and the CFTC agree that such a consequence would be counterproductive and increase the risk of defaults by commercial entities? Please explain and provide all related analysis including cost-benefit analysis.
11. Do you agree that commercial entities often seek non-margining agreements to avoid the risk of margin calls that can result from adverse mark to market changes in the value of a hedge?
12. In cases where variation margin applies to commercial entities, do you agree that the potential for price volatility in the short run will increase the need to reserve capital and cash flow risk despite an ability to satisfy the hedge in the long run through earnings from commercial operations? Please consider the case of Metallgesellschaft AG in your response. Please explain and provide all related analysis including cost-benefit analysis.
13. Do the Prudential Regulators agree that broadening eligible collateral for uncleared swaps to include liens on physical assets could reduce an entity's need to reserve cash or other liquid collateral for margin calls, while adequately securing a swap dealer against default risk? In your response, please also consider assets that generate "right way risk" as described in Part I.B.v., herein. Please provide all related analysis including cost-benefit analysis.
14. Are the Prudential Regulators seeking to increase demand for Treasury and Agency debt by excluding reasonable alternative forms of collateral? Please explain and specifically explain why corporate highly rated bonds, physical assets or those commodities deemed to provide "right way risk" are not sufficient as collateral. Please explain and provide all related analysis including cost-benefit analysis. Please also provide communications among senior staff and executives pertaining to this issue.

Economic Impact of the Proposed Margin Requirements

15. Do the Prudential Regulators and the CFTC expect that the Proposed Margin Requirements will require increased posting of collateral on an aggregate basis? Please provide all analysis by the Prudential Regulators or the CFTC that estimates changes to posted collateral in the aggregate and for each major participant type, such as commercial end-users. Please also provide communications among senior staff and executives pertaining to this issue.
16. Please provide all analysis by the Prudential Regulators and the CFTC regarding expected increases to segregated collateral following implementation of the Proposed Margin Requirements. Please explain and provide all related analysis including cost-benefit analysis. Please also provide communications among senior staff and executives pertaining to this issue.
17. Do you expect an increase in demand for Treasury and Agency debt based on the implementation of the Proposed Margin Requirements? How much of this increase is expected to be based on the

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increased collateral requirements relating to commercial end-users, swap dealers and DCOs, separately? Please explain and provide all related analysis including cost-benefit analysis. Please also provide communications among senior staff and executives pertaining to this issue.

18. Is an increased demand for Treasury and Agency debt one of the benefits the Prudential Regulators expect to yield from the Proposed Margin Requirements? Please explain and provide all related analysis including cost-benefit analysis. Please also provide communications among senior staff and executives pertaining to this issue.
19. Do you expect the Proposed Margin Requirements, in the aggregate, to increase the cost of capital for commercial businesses while reducing the cost of capital for the Federal Government? Please explain and provide all related analysis including cost-benefit analysis. Please also provide communications among senior staff and executives pertaining to this issue.

The Committee on Oversight and Government Reform is the principal oversight committee of the House of Representatives and may at "any time" investigate "any matter" as set forth in House Rule X. An attachment to this letter provides additional information about responding to the Committee's request.

We request that you provide the requested documents and information as soon as possible, but no later than 5:00 p.m. on Monday August 5, 2011. When producing documents to the Committee, please deliver production sets to the Majority Staff in Room 2157 of the Rayburn House Office Building and the Minority Staff in Room 2471 of the Rayburn House Office Building. The Committee prefers, if possible, to receive all documents in electronic format.

If you have any questions about this request, please contact Peter Haller or Rafael Maryahin of the Committee Staff at 202-225-5074. Thank you for your attention to this matter.

Sincerely,



Darrell Issa
Chairman

Enclosure

cc: The Honorable Elijah E. Cummings, Ranking Minority Member
Committee on Oversight and Government Reform

The Honorable Timothy Geithner, Secretary
U.S. Department of the Treasury

ONE HUNDRED TWELFTH CONGRESS

Congress of the United States

House of Representatives

COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

2157 RAYBURN HOUSE OFFICE BUILDING

WASHINGTON, DC 20515-6143

Majority (202) 225-5074
Minority (202) 225-5051

Responding to Committee Document Requests

1. In complying with this request, you should produce all responsive documents that are in your possession, custody, or control, whether held by you or your past or present agents, employees, and representatives acting on your behalf. You should also produce documents that you have a legal right to obtain, that you have a right to copy or to which you have access, as well as documents that you have placed in the temporary possession, custody, or control of any third party. Requested records, documents, data or information should not be destroyed, modified, removed, transferred or otherwise made inaccessible to the Committee.
2. In the event that any entity, organization or individual denoted in this request has been, or is also known by any other name than that herein denoted, the request shall be read also to include that alternative identification.
3. The Committee's preference is to receive documents in electronic form (i.e., CD, memory stick, or thumb drive) in lieu of paper productions.
4. Documents produced in electronic format should also be organized, identified, and indexed electronically.
5. Electronic document productions should be prepared according to the following standards:
 - (a) The production should consist of single page Tagged Image File ("TIF"), files accompanied by a Concordance-format load file, an Opticon reference file, and a file defining the fields and character lengths of the load file.
 - (b) Document numbers in the load file should match document Bates numbers and TIF file names.
 - (c) If the production is completed through a series of multiple partial productions, field names and file order in all load files should match.

6. Documents produced to the Committee should include an index describing the contents of the production. To the extent more than one CD, hard drive, memory stick, thumb drive, box or folder is produced, each CD, hard drive, memory stick, thumb drive, box or folder should contain an index describing its contents.
7. Documents produced in response to this request shall be produced together with copies of file labels, dividers or identifying markers with which they were associated when they were requested.
8. When you produce documents, you should identify the paragraph in the Committee's request to which the documents respond.
9. It shall not be a basis for refusal to produce documents that any other person or entity also possesses non-identical or identical copies of the same documents.
10. If any of the requested information is only reasonably available in machine-readable form (such as on a computer server, hard drive, or computer backup tape), you should consult with the Committee staff to determine the appropriate format in which to produce the information.
11. If compliance with the request cannot be made in full, compliance shall be made to the extent possible and shall include an explanation of why full compliance is not possible.
12. In the event that a document is withheld on the basis of privilege, provide a privilege log containing the following information concerning any such document: (a) the privilege asserted; (b) the type of document; (c) the general subject matter; (d) the date, author and addressee; and (e) the relationship of the author and addressee to each other.
13. If any document responsive to this request was, but no longer is, in your possession, custody, or control, identify the document (stating its date, author, subject and recipients) and explain the circumstances under which the document ceased to be in your possession, custody, or control.
14. If a date or other descriptive detail set forth in this request referring to a document is inaccurate, but the actual date or other descriptive detail is known to you or is otherwise apparent from the context of the request, you should produce all documents which would be responsive as if the date or other descriptive detail were correct.
15. The time period covered by this request is included in the attached request. To the extent a time period is not specified, produce relevant documents from January 1, 2009 to the present.
16. This request is continuing in nature and applies to any newly-discovered information. Any record, document, compilation of data or information, not produced because it has not been located or discovered by the return date, shall be produced immediately upon subsequent location or discovery.

17. All documents shall be Bates-stamped sequentially and produced sequentially.
18. Two sets of documents shall be delivered, one set to the Majority Staff and one set to the Minority Staff. When documents are produced to the Committee, production sets shall be delivered to the Majority Staff in Room 2157 of the Rayburn House Office Building and the Minority Staff in Room 2471 of the Rayburn House Office Building.
19. Upon completion of the document production, you should submit a written certification, signed by you or your counsel, stating that: (1) a diligent search has been completed of all documents in your possession, custody, or control which reasonably could contain responsive documents; and (2) all documents located during the search that are responsive have been produced to the Committee.

Definitions

1. The term "document" means any written, recorded, or graphic matter of any nature whatsoever, regardless of how recorded, and whether original or copy, including, but not limited to, the following: memoranda, reports, expense reports, books, manuals, instructions, financial reports, working papers, records, notes, letters, notices, confirmations, telegrams, receipts, appraisals, pamphlets, magazines, newspapers, prospectuses, inter-office and intra-office communications, electronic mail (e-mail), contracts, cables, notations of any type of conversation, telephone call, meeting or other communication, bulletins, printed matter, computer printouts, teletypes, invoices, transcripts, diaries, analyses, returns, summaries, minutes, bills, accounts, estimates, projections, comparisons, messages, correspondence, press releases, circulars, financial statements, reviews, opinions, offers, studies and investigations, questionnaires and surveys, and work sheets (and all drafts, preliminary versions, alterations, modifications, revisions, changes, and amendments of any of the foregoing, as well as any attachments or appendices thereto), and graphic or oral records or representations of any kind (including without limitation, photographs, charts, graphs, microfiche, microfilm, videotape, recordings and motion pictures), and electronic, mechanical, and electric records or representations of any kind (including, without limitation, tapes, cassettes, disks, and recordings) and other written, printed, typed, or other graphic or recorded matter of any kind or nature, however produced or reproduced, and whether preserved in writing, film, tape, disk, videotape or otherwise. A document bearing any notation not a part of the original text is to be considered a separate document. A draft or non-identical copy is a separate document within the meaning of this term.
2. The term "communication" means each manner or means of disclosure or exchange of information, regardless of means utilized, whether oral, electronic, by document or otherwise, and whether in a meeting, by telephone, facsimile, email, regular mail, telexes, releases, or otherwise.
3. The terms "and" and "or" shall be construed broadly and either conjunctively or disjunctively to bring within the scope of this request any information which might

otherwise be construed to be outside its scope. The singular includes plural number, and vice versa. The masculine includes the feminine and neuter genders.

4. The terms "person" or "persons" mean natural persons, firms, partnerships, associations, corporations, subsidiaries, divisions, departments, joint ventures, proprietorships, syndicates, or other legal, business or government entities, and all subsidiaries, affiliates, divisions, departments, branches, or other units thereof.
5. The term "identify," when used in a question about individuals, means to provide the following information: (a) the individual's complete name and title; and (b) the individual's business address and phone number.
6. The term "referring or relating," with respect to any given subject, means anything that constitutes, contains, embodies, reflects, identifies, states, refers to, deals with or is pertinent to that subject in any manner whatsoever.

Appendix A

A graphic reflection of the anticipated impacts of the new margin requirements as proposed by the Prudential Regulators and the CFTC

(Click mouse or spacebar to begin presentation
and to progress through slide)

